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VIA ELECTRONIC SUBMISSION

Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Control and Divestiture Proceedings (Federal Reserve Board Docket No. R-1662, RIN 7100-AF 49)

Dear Ms. Misback:

We are submitting this letter on behalf of one or more savings and loan holding companies ("SLHCs") to provide comments on the notice of proposed rulemaking the ("Proposal") by the Board of Governors of the Federal Reserve System (the "FRB") regarding determinations of control under the Bank Holding Company Act ("BHC Act") and the Home Owners' Loan Act ("HOLA").[1]

The Proposal has significant implications for SLHCs, as ensuring appropriately calibrated approaches to control are essential for all SLHCs to enable permissible non-controlling investments, including in small business and start-ups, in situations where neither the investee companies nor the investing SLHCs wish the investees to become subject to the full panoply of requirements that are imposed on affiliates of depository institutions. The control rules are similarly important for potential investors *in* SLHCs that may wish to invest equity in the industry without assuming SLHC status.

We support the FRB's objective of clarifying the FRB's controlling influence precedents and welcome the modifications to those precedents included in the Proposal, as justified by compelling policy concerns and the FRB's years of experience in administering the control standards. To cite one example, we support the FRB's proposed modification of precedent regarding divestitures of

1 Control and Divestiture Proceedings, 84 Fed. Reg. 21634 (May 14, 2019).

control. We nevertheless believe that the Proposal can be modified in several respects to better fulfill the FRB's objectives and avoid unduly constraining non-controlling investments by SLHCs.

Executive Summary

Although we welcome the many positive aspects of the Proposal, we respectfully submit that certain aspects of the Proposal could inadvertently result in unwarranted determinations of control and should be modified to avoid unnecessarily burdening SLHCs and investors in SLHCs. In particular:

- The final rule should permit additional flexibility with respect to business relationships. As proposed, the business relationship limits seem unduly restrictive and burdensome and thereby could stifle investment, including in emerging fintech companies and other small businesses. It is also important to confirm that SLHCs may use Statutory Accounting Principles ("SAP") rather than U.S. generally accepted accounting principles ("GAAP") in calculating the components of business relationship thresholds.

- Consistent with FRB precedent, presumptions of control should allow more leeway for an investment made by an SLHC if there is another party that is the majority controlling investor. For example, the generally applicable business relationship thresholds of the final rule should be higher when there is a majority controlling investor in the investee.

- Non-controlling investors should be permitted to maintain protective rights that ensure the soundness of minority investments, and the term "limiting contractual right" should be defined accordingly.

- The treatment of total equity should be revised. Specifically, standards for evaluating whether interests are "functionally equivalent" to equity, the requirement to recalculate total equity, and the look-through method for assessing equity investments should be eliminated.

- The FRB should clarify whether it intends to change the interpretation of contributed capital under HOLA from shareholders' equity to paid-in capital, and, if so, seek further comment on the issue.

- The treatment of non-voting securities that are not immediately convertible to voting securities should be revised and rationalized.

- The accounting consolidation presumption of control should be eliminated because it unnecessarily burdens common financing structures.

- The exception for shares held in a fiduciary capacity should be revised so that it is both consistent with the BHC Act and HOLA and does not impede banking organizations' normal trust and fiduciary businesses.
- The FRB should not attribute to an investor equity held by a company in which it has a non-controlling investment.
- The same control framework should apply to Regulations O and W to eliminate unnecessary compliance burden on SLHCs.

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I. The final rule should permit additional flexibility with respect to business relationships.

The Proposal includes a tiered approach to business relationships. For investments of 5% or more of a class of a second company's voting securities, the Proposal would presume control based on the amount of business relationships between the investor and that company, measured according to the proportion of revenues and expenses of each devoted to the other. Specifically, investments of less than 10% of voting equity would have business relationships restricted to 10% of the revenues and expenses of the investor and second company; investments between 10% and 14.99% would have business relationships restricted to 5% of revenues and expenses; and investments of 15% or more would have business relationships restricted to 2%.[2]

This approach seems unduly restrictive and could make transactions between SLHCs and other companies, particularly emerging companies and small businesses, unfeasible in many cases, because business relationships between an SLHC and emerging investee companies would often exceed the proposed thresholds. We respectfully submit that an SLHC's ranking among the top 50, top 20 or top 10 customers of an investee does not meaningfully add to the very limited ability to influence management that the SLHC might have as a minority investor. And, from a public policy perspective, it is desirable to avoid inhibiting important SLHC investments in small fintech, insurtech, and regtech companies, among others, and thereby diminishing those companies' ability to offer innovative products and services to consumers and the economy at large.

For these reasons, we recommend the following changes.

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[2] *See* 84 Fed. Reg. at 21658-21659 (to be codified at 12 C.F.R. § 225.32(d)(4), (e)(3)(ii), (f)(4)).

- Increasing thresholds.[3] As noted, the business relationship thresholds seem inappropriately restrictive. We suggest that the thresholds should focus on revenues of the investee company and be modified, at a minimum and subject to the below further comments, as follows: (1) no restrictions on revenues for investments of 9.99% or less of any class of voting securities; (2) 20% of the second company's revenues for investments of 10% to 14.99% of any class of voting securities; and (3) 10% of the second company's revenues for investments of 15% to 24.99% of any class of voting securities.

- Eliminating consideration of expenses.[4] The presumption should be modified so that expenses of either party are not considered in assessing the significance of business relationships. We believe that expenses of either the investor or the second company are an unreliable indicator of whether a controlling influence or incentive to exert control exists. Among other shortcomings, expenses of the investor do not measure its ability to control. Expenses of the investee are also a poor measure of influence because the measure fails to account for the common circumstance that the investee may easily replace the services provided, which, like a borrower's ability to terminate a loan early, significantly diminishes the investor's ability to influence the investee through its provision of services to the investee. Moreover, expense measurements may overstate influence in certain circumstances, such as where the investee has relatively few other expenses.

- Eliminating the regular monitoring requirement.[5] The presumption should be modified to consider the percentage of business relationships between an investor and second company only at the time of an equity investment, basing the denominator on the most recent annual report or other financial statement. The threshold implied by that financial statement would remain effective until the investor's next equity investment, when it would be recalculated. Not only would the implicit monitoring requirement increase compliance burden, but it also would have the perverse effect of mandating that investors become more involved in a second company's affairs than ordinary, arms-length business relationships normally would

3 *See* Question 5, 84 Fed. Reg. at 21641.

4 *See* Question 4, 84 Fed. Reg. at 21641.

5 *See* Question 8, 84 Fed. Reg. at 21641.

entail. Moreover, without such modification, an investor would be much more likely to be deemed to obtain a controlling influence as a result of events outside of the investor's control, such as an unexpected or significant decrease in the revenues of the investee company.

- Excluding routine business relationships.[6] We suggest that the calculation of revenues should be modified to exclude arms-length lending, deposit, and other relationships where similar services are available from third parties in competitive markets and there is no exclusivity arrangement between the investor and second company. This recommendation is consistent with FRB precedent, which recognizes that these relationships do not pose material controlling influence concerns.[7]

- Excluding referral fees from revenue calculations.[8] The FRB should clarify that referral fees should not be included within the calculation of the amount of revenue attributable to an investment because they provide little, if any, ability to influence another party. The decision to initiate the business relationship on which the referral is based, as well as its scope and the decision to terminate the relationship, are made by a third party; the referring party does not control these decisions.

II. Consistent with FRB precedent, presumptions of control should account for a majority controlling party.

The presence of an independent third party that controls a majority of any class of voting securities of a company significantly diminishes, if not completely eliminates, a minority shareholder's ability to exercise a controlling influence over that company.[9] The FRB has previously recognized that countervailing majority

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6 *See* Question 7, 84 Fed. Reg. at 21641.

7 *See, e.g.,* FRB Letter dated Apr. 2, 2013 to The Bank of Santa Barbara (finding that a transaction to be made at a "one-time set-price…negotiated at arms' length and on market terms" would not result in either party becoming "economically dependent on, or subject to influence" because it did not implicate controlling influence concerns). *See also* Federal Reserve Board, Policy statement on equity investments in banks and bank holding companies at 13 (Sept. 22, 2008), http://www.federalreserve.gov/newsevents/press/bcreg/bcreg%2020080922b1.pdf (business relationships that are on market terms, non-exclusive, and terminable without penalty are less likely to indicate a controlling influence) (hereinafter, "2008 Policy Statement").

8 *See* Question 4, 84 Fed. Reg. at 21641.

9 *See* Questions 32 and 33, 84 Fed. Reg. at 21647.

shareholders exercise "complete control" over their investments, and that their judgment is not apt to be changed by minority investors.[10]

We suggest that the FRB revise the Proposal to incorporate this critical element of FRB precedent. Specifically, the control presumptions should be less restrictive where there is a majority shareholder. We suggest that the presumptions should permit business relationships at 1.5 times the level permitted for minority investments at each tier when there is no majority investor.

III. Protective rights that ensure the soundness of minority investments are needed.

The FRB has historically taken the position that rights that "substantially limit the discretion of a banking organization's management over major policies and decisions" raise controlling influence concerns.[11] As an attempt to codify this standard, the Proposal includes a presumption of control for investors owning 5% or more of any class of a second company's voting securities that have a "limiting contractual right." This term means rights that "restrict significantly" the "discretion" of a second company over its operational or policy decisions.[12] The Proposal presents a general definition of the term as well as non-exhaustive lists of rights that both would and would not meet this standard.[13]

<u>General Definition of "Limiting Contractual Right" Is Vague</u>. Without clear guidance regarding the definition of "limiting contractual right," this aspect of the Proposal appears contrary to a key goal of the Proposal—clarifying the controlling influence test—and also seems unnecessarily restrictive of reasonable protective measures that minority investors seek precisely because they do not control the investee company. Reasonable opinions may differ as to whether almost any contractual right "significantly" restricts the discretion of a second company over its operational and policy decisions. The uncertainty such a subjective standard injects into transactions could chill investment by and in SLHCs. Accordingly, we suggest deleting the Proposal's general definition of limiting contractual right

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10 *See, e.g.*, Patagonia Corp., 63 Fed. Res. Bull. 288, 293 (1977). *See also Vickars-Henry Corp. v. Fed. Reserve Sys.*, 629 F.2d 629 (9th Cir. 1980); *cf.* 84 Fed. Reg. at 21659 (to be codified at 225.32(d)(6)).

11 2008 Policy Statement at 13.

12 84 Fed. Reg. at 21658 (to be codified at 12 C.F.R. § 225.32(d)(5)).

13 84 Fed. Reg. at 21663 (to be codified at 12 C.F.R. § 238.21(e)(5)).

and making the list of "examples" of limiting contractual rights an exclusive list, with the modifications that we recommend below.

Specific Examples of Limited Contractual Rights Should Be Modified. It is not self-evident that each example of a limited contractual right in the Proposal "significantly" restricts management of investee companies. Indeed, many of the specified limiting contractual rights are reasonable and, we believe, are commonly sought by passive investors to help protect their investment expectations and not to otherwise influence the company. Therefore, by treating such rights as triggers of presumptive controlling influence, the Proposal risks discouraging investment by restricting rights that are limited in scope or merely reinforce protections provided under the law.[14] We believe that HOLA should not be interpreted to prohibit provisions that protect the investment expectations and limited minority investor rights of SLHCs. Such provisions do not present sufficiently compelling concerns regarding controlling influence to justify the negative impact on investment that prohibiting the rights may have. Specifically, we suggest exempting from the definition of "limiting contractual right" an investor's right to restrict or significantly influence decisions related to:

- Use of the investor's funds;
- Achieving certain financial targets or observing certain financial limits;
- Payment of dividends and redemption of securities;
- Ability to engage in a public offering or to list or de-list securities on an exchange;
- Authorization of the issuance of junior debt securities or amendment of equity or debt securities; or
- Ability to alter accounting methods and policies, or regulatory, tax, or liability status.

Finally, investors that hold less than 10% of an investee company's voting equity should not be deemed to have a controlling influence over that investee company even if the investors have the limiting contractual rights listed in the Proposal. This control presumption therefore should apply only when an investor holds 10% or more of any class of an investee company's voting securities.

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[14] *See* 84 Fed. Reg. at 21657 (to be codified at 12 C.F.R. § 225.31(e)(5)).

IV. The treatment of total equity should be revised; the proposed treatment of contributed capital should be studied further.

The Proposal includes several new elements with respect to total equity that could unnecessarily chill investment. Specifically, the Proposal presents standards for evaluating whether interests are "functionally equivalent" to equity,[15] a requirement to recalculate total equity,[16] and a look-through method for assessing equity investments.[17] We believe that each of these requirements should be eliminated. In addition, we believe that the treatment of contributed capital under section 10 of HOLA deserves more thorough analysis—including industry input—before adoption of a final control rule that defines this provision of HOLA.

Functionally Equivalent Concept Is Unclear.[18] The "functionally equivalent" to equity standard is unclear and would frustrate lending, investment, and ordinary course commercial arrangements because of the inevitable uncertainty that it introduces. The Proposal explains that this standard is meant to prevent evasion and will be infrequently invoked, but codifying a rule that specifically contemplates debt being treated as equity will inevitably compel investors to consider the regulatory treatment of debt interests. Because many of the standards are subjective (for example, what maturity suffices to qualify debt as "extremely long-dated"?) investors may choose not to enter transactions rather than to risk a control determination.[19] The FRB has recognized the damaging effect such uncertainty causes by proposing to codify its concededly complex control standards; it should not further complicate them with another "facts and circumstances" test.

Equity Recalculation Would Chill Investment.[20] The equity recalculation requirement would chill investment because investors could be presumed to control investee companies based on third party actions over which the investors have no control. The Proposal includes a requirement to recalculate total equity whenever an investor acquires control over, or ceases to control, an investee's

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15 *See* 84 Fed. Reg. at 21660 (to be codified at 12 C.F.R. § 225.34(c)).

16 *See id.* (to be codified at 12 C.F.R. § 225.34(e)).

17 *See id.* (to be codified at 12 C.F.R. § 225.34(d)).

18 *See* Question 47, 84 Fed. Reg. at 21651.

19 84 Fed. Reg. at 21660 (to be codified at 12 C.F.R. § 225.34(c)(3)(i)).

20 *See* Question 48, 84 Fed. Reg. at 21651.

equity interests.[21] By requiring recalculation upon divestment, the Proposal leaves open the possibility that a control presumption could be triggered without an increase in equity ownership or other control indicia. For instance, a non-pro rata redemption of shares by a second company could cause an investor to be presumed to control an investee company either at the time of redemption or when the investor subsequently sells shares. Similarly, a loss to the retained earnings of an investee company could cause an investor to be presumed to control it when the investor subsequently sells shares. The FRB should therefore not require recalculation of a non-controlling investor's equity interest upon a disposition of shares.

Look-Through Requirement Is Unnecessarily Complex.[22] We believe the Proposal's look-through requirement adds unnecessary complexity to the calculation of total equity. As proposed, equity investments in a second company's parent would be added (in proportion to the parent company's equity ownership of the second company) to the investor's equity investment in the second company.[23] This aggregation should be eliminated because it would require investors to understand whether the second company controls or is controlled by another company in which the investor also has an equity investment, which may not be publicly available information. As the FRB has acknowledged in other contexts,[24] imposing BHC Act or HOLA control analysis requirements outside the context of banking organizations is unduly burdensome. This is particularly true where there is no chain of control that could actually allow an investor to exercise a controlling influence over the second company via its related investments.[25]

Interpretation of Contributed Capital Should Be Clarified. The Proposal states in footnote 94 that contributed capital, as used in the definition of control in HOLA, "has generally been understood to mean paid-in capital."[26] We disagree. The Office of Thrift Supervision ("OTS") "consistently measured" contributions of

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21 *See* 84 Fed. Reg. at 21660. (to be codified at 12 C.F.R. § 225.34(e)).

22 *See* Question 37, 84 Fed. Reg. at 21649.

23 *See* 84 Fed. Reg. at 21660 (to be codified at 12 C.F.R. § 225.34(d)).

24 *See* 82 Fed. Reg. 42882, 42896 (Sept. 12, 2017) (explaining that the FRB's final rule regarding restrictions on qualified financial contracts ("QFC") was changed from the proposal to address comments that many QFC counterparties to GSIBs are not familiar with BHC Act control).

25 *See also infra* section IX.

26 *See* 84 Fed. Reg. at 21654.

capital for purposes of section 10 of HOLA in terms of GAAP shareholders' equity (including retained earnings),[27] and neither the FRB nor its staff, to our knowledge, has not opined on the meaning or calculation of contributed capital, aside from the language quoted above.

It is unclear whether the FRB, in footnote 94, intends to change the longstanding interpretation of contributed capital. If so, this would be a potentially significant change to the interpretation of the statutory term on which SLHCs and others have relied in structuring investments to avoid control.[28] Moreover, it is difficult to evaluate the significance of other possible consequences of the change because it is unclear how and when the FRB would expect paid-in capital to be calculated. For example, it is unclear whether the FRB would permit contributed capital to be measured at the time of the investment or reassessed when there have been material changes to the capital structure of the investee company.

Because of the significance of the change and the uncertainty it could create, we respectfully request that the FRB and its staff continue to evaluate various approaches to determining contributed capital and solicit input from the industry and other interested parties before resolving the issue. Among other questions, we suggest that the FRB consider whether contributed capital should be assessed one way in the context of investment in a start-up company and in a different way in the context of investment in a mature operating company. Without taking these necessary steps, we do not believe that the FRB should adopt the proposed interpretation.

V. Convertible nonvoting securities should not be treated as voting unless they are immediately exercisable.

The Proposal would treat control of convertible nonvoting securities that are not immediately convertible into voting securities (i.e., when there is an unfulfilled

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27 *See, e.g.*, Letter from Julie L. Williams, Senior Deputy Chief Counsel, OTS (Apr. 30, 1993); Letter from Julie L. Williams, Senior Deputy Chief Counsel, OTS (Sept. 15, 1992); Letters from Harris Weinstein, Chief Counsel, OTS (July 23, 1992).

28 *Cf. FCC v. Fox Television Studios, Inc.*, 556 U.S. 502, 515 (2009) ("[T]he requirement that an agency provide reasoned explanation for its action would ordinarily demand that it display awareness that it is changing position. . . . And of course the agency must show that there are good reasons for the new policy. . . . Sometimes it must [provide a more detailed justification than what would suffice for a new policy created on a blank slate]—when, for example, . . . its prior policy has engendered serious reliance interests that must be taken into account.").

condition to conversion) as control of the voting securities.[29] This interpretation of sections 10(a)(2)(A) and 2(a)(2)(A) of HOLA and the BHC Act, respectively, is inconsistent with the plain language of those statutes. Ownership of such convertible securities does not allow the investor to own or vote the voting securities, nor does ownership of such securities allow the controlling party to buy, sell, or otherwise transfer voting securities. Rather, such convertible securities would allow for control over voting securities only if a condition is fulfilled in the future. It is inconsistent with the intentional and distinct features of different corporate instruments to ascribe control of voting securities to an investor holding *non*-voting shares that become voting only upon the fulfillment of conditions that are outside the investor's control.[30]

In addition, the Proposal itself provides no rationale for the proposed treatment of convertible securities and does not cite to particular precedent for authority. Moreover, although such FRB precedent as exists regarding treatment of convertible securities seems somewhat unclear,[31] the Proposal appears to be inconsistent with FRB precedent.[32] For example, the Proposal would appear to

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29 *See* Question 38, 84 Fed. Reg. at 21649.

30 Moreover, the definitions of control under HOLA and the BHC Act are written in the present tense, and interpreting the terms to include future contingencies would not only impermissibly add words to the statute (e.g., "controls, or would control,") but also be unworkable if consistently applied, as it would require the FRB to assume that all eventualities that could result in control of voting securities of a company do result in control of such voting securities. *See* 12 U.S.C. § 1841(a)(2)(A) ("Any company has control over a bank or over any company if—the company directly or indirectly or acting through one or more other persons *owns, controls, or has power to vote* 25 per centum or more of any class of voting securities of the bank or company…") (emphasis added); 12 U.S.C. § 1467a(a)(2)(A) (a person shall be deemed to have control of—a savings association if the person directly or indirectly or acting in concert with one or more other persons, or through one or more subsidiaries, *owns, controls, or holds with power to vote, or holds proxies representing*, more than 25 percent of the voting shares of such savings association…") (emphasis added).

31 *Compare* FRB Letter dated Mar. 17, 1977 to Sharon Jobe on behalf of Republic of Texas Corporation (allowing the ownership of warrants for 100% of a class of voting securities as long as they are not exercised) *with* 12 C.F.R. § 225.143 (placing limits on ownership of warrants for non-controlling investors).

32 The proposed treatment of convertible securities also is internally inconsistent. Although it purports to be an interpretation of the 25% voting securities tests in the BHC Act and HOLA, it is based, at least in part, on the controlling influence test. For example, the exception includes transfer to a 50% shareholder, whereas sections 10(a)(2)(A) and 2(a)(2)(A) apply control regardless of whether there is a larger shareholder. *See* 84 Fed. Reg. at 21656 (to be codified at 12 C.F.R. § 225.9(a)(3)(ii)(D)). In other words, a larger shareholder reduces the ability of an investor to influence another company but it does not affect the amount of voting shares of the other company that an investor controls. In addition, FRB precedent is inconsistent as to whether the treatment of convertible securities is an interpretation of the

treat convertible securities as voting even when the unfulfilled contingency is a change in federal law; whereas FRB precedent seems to recognize that such an unfulfilled contingency allows nonvoting securities to be treated as nonvoting.[33] As another example, the FRB has held that preferred shares with voting rights only in certain circumstances (such as the right to elect directors when dividends are in arrears) are only "voting securities" for purposes of Regulation Y when those voting rights are active.[34] Because the rationale for the proposal is unclear at best, commenters are unable to address the FRB's legal reasoning or underlying concerns. Accordingly, the Proposal provides no meaningful opportunity to comment on the proposed treatment of convertible securities.[35]

For these reasons, the FRB should not finalize its proposed interpretation of control of convertible securities (with an unfulfilled condition to conversion) as control of voting shares. If the FRB intends to continue its look-through approach for convertible securities, the approach should, at a minimum, be properly conditioned as are most of the other indicia of control cited in the Proposal. For example, convertible securities could be treated similarly to nonvoting equity and subject to similar thresholds.

25% test or the controlling influence prong of control. *Compare* 12 C.F.R. § 225.31(d)(1) (presuming an investor controls immediately convertible securities) *with* FRB Staff Opinion of May 14, 1984 (Fed. Res. Reg. Serv. 4-397.2) ("In summary, the acquisition of [immediately convertible] stock gives the holder the power to direct the management or policies of the company."). Moreover, using a controlling influence rationale to interpret the 25% tests would, in certain cases, nullify the statutory presumption of non-control in the BHC Act for the controlling influence test. *See* 12 U.S.C. § 1841(a)(3) (presuming that a holder of less than 5 percent of any class of voting securities of a company does not control that company).

[33] *See, e.g.,* 12 C.F.R. § 225.143; FRB Letter dated Oct. 31, 1986 to Robert L. Tortoriello (permitting Norstar Bancorp to acquire 20% of the total equity of an entity conducting activities that were impermissible for a bank holding company, via convertible nonvoting securities that could not be exercised until such activities were permissible for a bank holding company).

[34] *See* FRB Letter dated Dec. 7, 2012 to Joseph J. Samarias at 3 (citing 49 Fed. Reg. 794, 800 (1984)), https://www.federalreserve.gov/supervisionreg/legalinterpretations/bhc_changeincontrol20121207a.pdf.; 12 C.F.R. § 225.2(q)(2).

[35] *See* 5 U.S.C. § 553(b)-(c); *U.S. v. Nova Scotia Food Products Corp.*, 568 F.2d 240, 251 (2d Cir. 1977) ("If the failure to notify interested persons of the [basis] upon which the agency was relying actually prevented the presentation of relevant comment, the agency may be held not to have considered all 'the relevant factors.'").

VI. GAAP consolidation should not restrict common financing structures.

The FRB should eliminate the presumption of control over entities consolidated under GAAP to avoid unduly burdening passive financing vehicles or, at a minimum, revise the presumption to exclude such vehicles. Relying on a separate, non-governmental organization to set and revise control standards, especially where the underlying objectives of the organization's accounting consolidation rules differ materially from those of HOLA, is not the best way to implement the FRB's policy goals. This is particularly true with respect to so-called variable interest entities ("VIEs"), which the Proposal would consider subsidiaries. VIEs may be entirely passive financing vehicles, such as vehicles that do nothing more than hold loans or other underlying assets on behalf of investors. These vehicles do not have management or policies to control, but may be VIEs under accounting standards if an SLHC has a service provider or other role with the entity (such as being a loan servicer). Therefore, treating these entities as controlled would not further HOLA's policy goals, but would cause unnecessary burden to SLHCs participating in customer-driven financing structures.

The Proposal also considers expanding the accounting consolidation presumption beyond GAAP. [36] The Proposal does not explain the rationale for doing so and does not assess its impact. In fact, its full impact cannot be known, considering the multiple accounting methods and their ability to change. Moreover, expanding the presumption would exacerbate the issues of reliance on standards set by a non-governmental organization effecting different policy goals, as discussed above. It would also produce inconsistent results based on those different standards and underlying policy choices. For example, GAAP, International Financial Reporting Standards ("IFRS") and SAP may produce different outcomes with respect to whether particular companies that are majority-owned would be consolidated. Therefore, at a minimum, the accounting consolidation presumption should not be extended beyond GAAP.[37]

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36 *See* Question 21, 84 Fed. Reg. at 21644.

37 For instance, consolidation under the National Association of Insurance Commissioners' statutory accounting principles is also an inappropriate means by which to effectuate the FRB's policy goals. These rules similarly have much different objectives than the FRB's control regulations. *See* National Association of Insurance Commissioners, Statutory Accounting Principles (May 17, 2019), https://www.naic.org/cipr_topics/topic_statutory_accounting_principles.htm ("Statutory Accounting Principles are designed to assist state insurance departments in the regulation of

VII. The fiduciary exemption should be modified to be consistent with statute and facilitate ordinary trust and fiduciary activities of SLHCs.

The Proposal's presumptions of control do not apply to the extent that shares are held in a fiduciary capacity without sole discretionary authority to exercise the voting rights associated with those shares.[38] This exclusion appears to be based on similar statutory exclusions in the BHC Act and HOLA for shares acquired in a fiduciary capacity. However, the statutory prohibition regarding sole discretionary voting authority applies solely with respect to acquisitions of bank shares.[39] It is found nowhere in section 10 of HOLA or section 4 of the BHC Act. In fact, HOLA's fiduciary exemption regarding the acquisition of savings associations applies "whether [the fiduciary acquires the shares] with or without the sole discretion to vote such shares."[40]

SLHCs acting in a fiduciary capacity, even with sole discretionary voting authority, have important limitations on their voting decisions due to state law duties of prudence, loyalty, and impartiality. Fiduciaries must vote shares held in a fiduciary capacity in the best interest of the beneficiaries and may not, instead, base voting decisions on their own interest.[41] Accordingly, voting decisions by the same fiduciary may diverge based on differing interests of the beneficiaries, and the voting power of a fiduciary is likewise more attributable to the beneficiaries than the fiduciary.

Moreover, the sole discretionary voting condition would needlessly increase the complexity of trust administration and similar fiduciary activities. The fiduciary exception was intended to allow banking organizations to carry on normal trust and other fiduciary activities and, in many such cases, fiduciaries are granted sole discretionary voting rights based solely on the preferences of the settlor (and possibly without the prior knowledge of the fiduciary). In fact, the sole discretionary voting authority condition in section 3 of the BHC Act implicitly

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the solvency of insurance companies…SAP is developed in accordance with the concepts of consistency, recognition and conservatism.").

38 *See* 84 Fed. Reg. at 21659 (to be codified at 12 C.F.R. § 225.32(k)). *See also* Question 56, 84 Fed. Reg. at 21654.

39 12 U.S.C. §§ 1841(a)(5)(A), 1842(a).

40 12 U.S.C. § 1467a(e)(1)(A)(iii)(I).

41 Restatement (Third) of Agency, § 8.01 General Fiduciary Principle ("[T]he general fiduciary principle requires that the agent subordinate the agent's interests to those of the principal and place the principal's interests first as to matters connected with the agency relationship.").

acknowledges this fact by essentially allowing companies a two-year period to conform to its requirements.

VIII. The same control framework should apply to Regulations O and W.

The FRB should harmonize its control presumptions under Regulations O, W, and LL to the extent permissible by statute.[42] The additional complexity and concomitant compliance burden associated with three different sets of control presumptions is unnecessary and increases the confusion of many investee companies, which are likely to be unfamiliar with the FRB's approach. The statutory authorities for the definition of control and controlling influence largely use the same language.[43] Moreover, there does not appear to be a pressing policy need for these concepts to be interpreted differently, and the Proposal does not provide one. Because the FRB has the ability to harmonize these regulations, which would simplify analysis necessary to a wide variety of banking transactions, without harm to its policy goals, it should incorporate the final rule's standards into Regulations O and W.[44]

IX. Shares controlled by non-controlling investments should not be attributed to the non-controlling investor.

Question 45 asks whether, in circumstances in which a first company has a non-controlling investment in a second company, shares of a third company that is owned by the second company should be attributed pro rata to the first company for purposes of calculating the first company's voting percentage in the second company.[45] As a matter of law and policy, the FRB should not attribute shares of the third company to the first company if the first company does not control the second company. Such attribution would be inconsistent with section 2(g) of the BHC Act, which only provides for attribution of shares of a third company where

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42 We understand that such modifications may require separate rulemakings and, to the extent the FRB determines separate rulemakings are required, request that the FRB initiate such rulemakings for the reasons described herein. *See* 5 U.S.C. § 553(e). *See also* Question 56, 84 Fed. Reg. at 21654.

43 *Compare* 12 U.S.C. § 1467a(a)(2) *with* 12 U.S.C. § 375b(9)(B) *and* 12 U.S.C. § 371c(b)(3).

44 To the extent Regulations O and W are harmonized with the control framework of Regulations Y and LL, the FRB should take care to ensure that the control standards of Regulation LL—and not Regulation Y—apply to savings associations. Imposing Regulation Y standards on savings associations via Regulation O and Y would unduly burden the institutions and run contrary to the purpose of harmonizing these regulations, by requiring the institutions to apply another set of control standards that are not tailored to them.

45 *See* 84 Fed. Reg. at 21650.

there is control of the second company.[46] More generally, there appears to be no statutory authority under HOLA or the BHC Act to make such attribution because the first company clearly does not own shares of the third company and there is no way for the first company to control such shares.[47] Further, this approach would impose a significant burden on regulated institutions and their investors as they would have to track all the investments of their investments on a continuous basis. Such tracking could be quite difficult where an investor owns only a small minority of a company, as the company's investment information may not be public. This approach may also trigger onerous filing requirements, and inadvertent violations of such filing requirements, for SLHCs if, for example, the second company is not a depository institution holding company but owns shares of a savings association.[48]

X. Conclusion

We applaud many aspects of the Proposal and believe they should be adopted as proposed. In finalizing the Proposal, we request, for the reasons explained above, that the FRB should also make targeted adjustments to the Proposal that would comport with HOLA and other applicable statutory provisions, decrease regulatory burden on SLHCs, and facilitate non-controlling investments without detriment to the FRB's policy goals.

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[46] *See* 12 U.S.C. § 1841(g)(1). Negative implication is a fundamental principal of statutory interpretation. *See, e.g.*, *Bates v. United States*, 522 U.S. 23, 29 (1997); *Meghrig v. KFC Western, Inc.*, 516 U.S. 479, 485 (1996); *Keene Corp. v. United States*, 508 U.S. 200, 208 (1993) (quoting *Russello v. United States*, 464 U.S. 16, 23 (1983)).

[47] *See* 12 U.S.C. §§ 1841(a)(2)(A), 1467a(a)(2)(A). The first company also clearly does not hold with the power to vote shares of the third company. *See id.* at § 1467a(a)(2)(A).

[48] For example, if an SLHC had a non-controlling investment of 21.0% of the voting securities of a second company that had a non-controlling investment of 24.0% of the voting securities of a savings association, attribution of shares of the savings association would require the SLHC to seek FRB approval for its ownership without serving any clear regulatory purpose for the filing requirement. *See* 12 U.S.C. § 1467a(e)(1)(A)(iii). Moreover, such attribution could cause inadvertent violations of the filing requirement because the investing SLHC may not know or have reason to know of the second company's ownership of the shares of the savings association.

We appreciate the opportunity to comment on the Proposal and would be pleased to answer any questions that you might have concerning our comments.

Respectfully submitted,

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